[22] The testimony, and the proposed marketing statement gives only an idea of the enormous opportunity that Pacific, as the incumbent local service provider, will have to abrogate equal access requirements and engage in other anticompetitive activity, and their willingness to do so.

One other public interest concern that appears to be impacted by the proposal before the Commission is the interest in ensuring that a customer has a clear understanding regarding which company is providing service to them. Admittedly, the telecommunications market is in constant flux, and the events of the past ten years have caused considerable customer confusion. The opening of local markets, as well as long distance markets will, as a matter of course, create a certain amount of customer confusion in and of itself. This alone would seem to compel a certain stridency regarding the importance of avoiding customer confusion.

Rather than express any concern about this however, PB Com appears to want to rely on customer confusion to obtain and retain its customers, by refusing to explain the nature of it's entity. PB Com and Pacific both intend to use the Pacific Bell brand name. In testimony, witness Jacobson explained that he was "not sure that there is going to be a great effort on our part to have customers make that distinction" between PB Com and Pacific Bell..."we don't think it will serve the customer all that well to force them to understand whether they're buying from the core Pacific Bell or from one subsidiary."[23] This attitude reflects not only disdain for informing its customers, but an

---

[22] Ex. C-30.

[23] Tr. Vol. 1, Jacobson, PB Com at 40, 42.

effort to present PB Com as the same entity as Pacific Bell, an effort which no doubt also reflects a limited respect for the "acting independently" and "arms length" requirements of the Act.

C. Serious Anticompetitive Concerns are Raised by PB Com's Proposal

The concerns regarding the promotion of viable competition in this proceeding have been repeated by all witnesses, including those representing PB Com. The evidence shows, however, that the relationship between Pacific Bell and PB Com, and the provision of local exchange services by PB Com, provide an ample opportunity for Pacific to evade the regulations that govern it; particularly pricing regulations. For example, the transfer of customers from one entity to another which may have less, or no, pricing restrictions affords Pacific Bell to opportunity to escape the Commission's regulations.

Moreover, if PB Com becomes a facilities-based carrier, as it has requested, Pacific Telesis can divert certain technology, or new technology, to the entity serving the "high value" customers, without providing that technology to wholesale customers. In geographic areas served by PB Com, Telesis could find its business interests best served by allowing its Pacific Bell network, serving wholesalers, to degrade, while upgrading PB Com's network, and bypass the regulatory obligation to provide competitors with access to the local exchange network.[24]

[24] Ex. 67, Nina Cornell, MCI, at 14.

The structure between Pacific Bell and PB Com also provides an opportunity to engage in anticompetitive pricing schemes, which evade the Commission's regulations regarding the establishment of price floors, if PB Com is not treated as a dominant carrier. For example, Pacific Bell could create a discounted volume and time commitment tariff that, while theoretically available to all, only its affiliate would actually be able to obtain. Moreover, PB Com's witness Jacobson has expressed PB Com's interest in obtaining services from Pacific pursuant to contract that reinforce the necessity for regulation to prevent anticompetitive and/or discriminatory pricing.

> Jacobson: I think it would be helpful if I explained that it's my understanding that carriers today buy switched access from Pacific Bell out of a tariff, but at some point in the future, if Pacific Bell is allowed to sell switched access under contract instead of tariff, ...then I think it would be important for PB Com to be able to buy under contract.
>
> Question: Now, if PB Com were purchasing access from Pacific Bell on a customer-specific contract basis and if the price offered to PB Com by Pacific Bell were lower than the price offered to any other competitor in the marketplace, would you not agree that that would be a form of discrimination intended to favor its corporate affiliate?
>
> Answer: It might be but it might not be.....
>
> Question: If the examination [by the Commission] showed that the rate offered to Pacific Bell Communications was lower than the rate offered to any other carrier in the marketplace, would you agree with me that that would be an appropriate basis for the Commission to reject the contract?
>
> Answer: No.....It could also be that the carriers may over time decide to not negotiate with Pacific Bell or to not enter into very long terms in their contracts with Pacific Bell because there will be competitive alternatives to Pacific Bell for switched access.

Anticompetitive conduct has been demonstrated as a result of Pacific Bell's control of the PIC change process. Pacific Bell has severely constrained the numbers of local exchange customers that will be able to switch their local carrier from Pacific Bell to a CLC. According to AT&T's witness Kargoll, Pacific Bell has notified competitive carriers that the number of customer changes for all resale competitors would be limited to 400 customers a day, five days a week, until the end of January 1996. After January, the number Pacific was "hoping" to accommodate increased to about 2,000 a day, five days a week, for all competitors.[25] In contrast, Pacific Bell has informed PB Com that it will have no problem processing or handling PB Com's orders.[26]

All of these concerns should compel the Commission to conclude PB Com has failed to comply with the Costa and Telecommunications Act requirements, and that it must impose dominant carrier status on PB Com once the CPCN is authorized.

---

[25] Tr. Vol 9, Kargoll, AT&T at 1138.

[26] Tr. Vol. 1, Jacobson, PB Com at 60.

III. <u>The FCC Order Limits This Commission's Ability to Provide For Clear Structural Safeguards That Would Otherwise Limit the Extent of Regulation Required For the Protection of the Public Interest. Dominant Carrier Regulation of the 272 Affiliate is Permitted</u>

In its <u>First Report and Order</u>, CC Docket 96-149, the FCC holds that

> the rules [it] establish[es] to implement section 272 are binding on the states, and the states may not impose regulations with respect to BOC provision of intrastate interLATA service that are inconsistent with section 272 and the Commission's rules under Section 272. [It] emphasize[s], however, that the scope of the Commission's authority under Section 271 and 272 extends only to matters covered by those sections.[27]

The FCC has found that the provision of local exchange services, either on a facilities or resold basis, by the 272 affiliate, does not violate the Telecommunications Act.[28] Providing a structural separation between the provision of long distance and local service for the BOC affiliate would have made this Commission's role as regulator much simpler, since structural separation provides an

---

[27] <u>FCC Order</u> at para 30. Of course, the FCC's ability to preempt intrastate jurisdictions is at this point a grey area, at best. See <u>Brief of Amicus Curiae, Dingell, Tauzin, Boucher, and Hastert</u>, U. S. Court of Appeals, 8th Circuit, "In the end, we decided to leave regulation of most local matters, including especially the pricing of local facilities and services, to the states. To implement that design, the House/Senate conference committee added specific language clearly vesting such authority in the state. Just as important, Congress left key provisions in the 1934 Act in place. These include Sec. 2(b), codified at 47 U.S.C. Sec. 152(b), which plainly states that "nothing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to ....intrastate communication service...There was no general effort to expand federal power through the 1996 Act. Rather, Congress was concerned with limiting federal regulation." <u>Iowa Utilities Board, et. al. vs. FCC, On Petitions for Review of an Order of the Federal Communications Commission</u>, No. 96-3321, November 15, 1996, at 3, 7. Nevertheless, CCTA will assume the FCC's preemption of intrastate authority in its Brief here.

[28] Id. at paras 312-316.

easy way to control cross-subsidy, anticompetitive activities, and other conduct contrary to the public interest. Thus as a result of the FCC's Order and findings, the importance of the California Commission to continue dominant-carrier type regulation has been underscored; the protections offered by structural separation must now be ensured by other regulatory means.

The FCC did, however, provide for State regulation insofar as the state regulates the integrated affiliate, and recognized the right of the State to regulate the integrated affiliate differently than other carriers.[29] Thus the California Commission is free to determine that dominant carrier regulation is appropriate for an affiliate of a BOC which provides both local and long distance services.

IV. The FCC Has Defined the "Acting Independently" Requirements to Exclude Certain Activities and Relations Between the BOC and the 272 Affiliate. PB Com and Pacific's Activities Do Not Comply With These Requirements

Despite its finding that structural separation was not required by the Act, the FCC did find that in order to comply with the "operate independently" requirements of Section 272(b)(1) requirements beyond those listed in sections 272(b)(2)-(5) were necessary. These requirements must also be considered in reviewing and authorizing PB Com's application. These requirements include:

1. No joint ownership between a BOC and its 272 affiliate of switching and transmission facilities; switching and transmission facilities are defined broadly to include the facilities used to provide local exchange and exchange access services

2. No joint ownership between a BOC and its 272 affiliate of the land and buildings where switching and transmission facilities are located;

[29] FCC Order at para 317.

3. The 272 affiliate is precluded from performing operating, installation, and maintenance functions associated with the BOC's facilities;

4. The BOC, or BOC affiliate, other than the 272 affiliate, is barred from performing operating, installation or maintenance functions associated with the facilities that the section 272 affiliate owns or leases from a provider other than the BOC with which it is affiliated

5. A 272 affiliate and its interLATA competitors will have to follow the same procedures when obtaining services and facilities on the same rates, terms and conditions available to unaffiliated entities;

6. Section 272(b)(1) bars a Section 272 affiliate from contracting with a BOC to obtain operating, installation and maintenance functions associated with the section 272 affiliate's facilities.[30]

The record shows that PB Com and Pacific are already engaged in a number of activities which violate these provisions:

Pacific Bell and PB Com have entered into an agreement entitled Consulting Services Network Operation Support, under which Pacific Bell agrees to assist PB Com on the operation and maintenance of the network; [31]

Pacific Bell and PB Com have entered into an agreement entitled Consulting Services Network Technology Support, which includes developing design requirements and implementing network developments.[32]

During the hearing at least 23 different Pacific Bell employees were identified as employees who continue to provide services to Pacific Bell Communications, [33] including employees who are working on operations projects;[34]

These relationships and contracts must be voided and prohibited for PB Com to

---

[30] Id. at paras 156-166.

[31] Tr. Vol 1, Jacobson, PB Com at 27, See also Ex. 5.

[32] Id. at 30, See also Ex. 6.

[33] Id. at 32, See also, Ex 7.

[34] Id. at 33.

comply with the Act's requirement to "operate independently.".

V. Reliance on Affiliate Transaction Reports and Antitrust Laws Is Insufficient to Protect the Public Interest

The affiliate transaction rules and the anti-trust laws were established to protect the public interest in preventing anti-competitive activities. PB Com is quick to assure the Commission that those safeguards are sufficient to protect the public interest and nothing further is required. Unfortunately, the Commission cannot rely on the assurances of PB Com. It put forth two witnesses to address these safeguards, each failed to show that in fact, the affiliate transactions rules and the anti-trust laws will prevent the types of abuses discussed herein.

A. The Pacific Telesis Companies Have Violated the Commission's Affiliate Transaction Rules

According to PB Com, the Commission's affiliate transactions rules are sufficient to assure that ratepayers are indifferent to the activities between Pacific Bell and its affiliates, and that the Pacific Telesis companies have systems and processes in place to assure compliance with the Commission's affiliate transactions rules.[35]

The evidence in this proceeding shows that not only are affiliate transaction rules inadequate to prevent certain types of anti-competitive abuses, but that Pacific has been found to routinely violate the rules.[36] For example, the National Association of Regulatory Utility Commissioners ("NARUC") and the FCC ordered, on separate

---

[35] Ex. 55, Testimony of Michael L. Silacci at 3.

[36] Tr. Vol. 5, Silacci, PB Com at 728, 734-735.

occasions, that audits be performed by independent auditors, on the Pacific Telesis companies' affiliate transactions. The NARUC audit report was issued in 1994 by the CPUC's Division of Ratepayer Advocates and the FCC audit report was issued in 1991 by the accounting firm of Ernst and Young. These audits found that the Pacific Telesis companies violated the affiliate transactions rules even while Pacific Telesis performed internal audits on its affiliate transactions on a semi-annual basis.[37]

The NARUC audit identified 26 instances where the DRA staff found that the actions of the Pacific Telesis companies regarding compliance were inappropriate.[38] Nevertheless, Pacific Telesis received no sanctions as a result of the NARUC audit.[39]

Moreover, as a result of the FCC audit, the Ernst and Young group reported

> numerous audit findings against the Bell Operating Companies, including Pacific, concerning apparent rule violations and conduct. These findings generally involve failures to keep accounts, memoranda and records in the manner prescribed by the Commission.[40]

Pacific Bell agreed, in settlement,

> that it has corrected former accounting and recordkeeping practices that might have contributed to the apparent violations set forth in the *Order to Show Cause* . . . [and] to establish procedures to prevent the specific apparent deficiencies from recurring in the future.[41]

---

[37] Id. at 719.

[38] Ex. 57 at B-15 - B-17.

[39] Tr. Vol. 5, Silacci, PB Com at 729.

[40] Ex. 60 at 3.

[41] Id. at 5.

Again, no sanctions were imposed. Pacific Telesis and its affiliates have no incentive to comply with the affiliate transactions rules of this Commission, or the FCC, as long as the only remedy required of them is to agree to amend their procedures.

Although PB Com has assured the Commission that the affiliate transactions rules "are comprehensive and sufficient to prevent cross-subsidy and anti-competitive behavior,"[42] PB Com cannot show that the affiliate transaction rules will prevent the ratepayer, consumer, and competitive abuses cited herein. The evidence shows that, for example, the affiliate transactions rules would not allow the Commission to determine whether PB Com were pricing its services below cost; whether Pacific Telesis was inappropriately investing in PB Com to the detriment of Pacific Bell; whether Pacific Bell was migrating higher value customers to PB Com; and whether CPNI that was provided to PB Com was also provided to other CLCs.[43]

Clearly, the Commission's affiliate transaction rules have not been shown to be, and are not, adequate to prevent the Pacific Telesis companies from manipulating and violating them. If the Commission is to create a competitive telecommunications industry, it must adopt additional rules to prevent anti-competitive behavior between Pacific Bell, PB Com, and their affiliates.

B. The Anti-Trust Laws Do Not Apply to Pacific Bell and its Affiliates

PB Com makes the same claim regarding anti-trust laws as it did regarding affiliate transactions rules. It claims that no additional safeguards are required because

[42] Ex. 55, Testimony of Michael L. Silacci at 6.

[43] Tr. Vol. 5, Silacci, PB Com at 737-738.

the federal and state anti-trust statutes "are, by themselves, adequate to promote and protect the competitive process,"[44] alleging that the Sherman Anti-trust Act and the Clayton Act are sufficient to curb anti-competitive behavior.[45]

Reliance on anti-trust doctrines is misplaced for a number of reasons. First, such reliance affords PB Com the opportunity to engage in anti-competitive abuses until such abuses are thoroughly litigated in the courts. Secondly, the evidence in the proceeding shows that numerous doctrines will in many cases prevent anti-trust actions from being brought against a regulated entity, such as Pacific Bell or PB Com.[46] In *Copperweld*, the Supreme Court held that "the coordinated activity of a parent and its wholly owned subsidiary must be viewed as that of a single enterprise for purposes of § 1 of the Sherman Act."[47] Therefore, as a matter of law, a corporation and its wholly owned subsidiaries "are incapable of conspiring with each other for purposes of § 1 of the Sherman Act."[48] In subsequent cases, the courts have expanded the application of *Copperweld* to include two wholly owned subsidiaries of a parent corporation (sister corporations).[49] According to this case law, anti-competitive behavior between PB Com

---

[44] Ex. 102, Testimony of Richard D. Emmerson at 30.

[45] Id. at 29-30.

[46] See *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984).

[47] Id. at 771.

[48] Id. at 777.

[49] See *Directory Sales Management Corp. v. Ohio Bell Telephone Co.*, 833 F.2d 606 (6th Cir. 1987).

and Pacific Bell, or between PB Com and Pacific Telesis is immune from the anti-trust laws.

PB Com provided no evidence in the record to support its claim that the anti-trust laws are adequate to promote and protect the competitive process. Moreover, PBCom's unfamiliarity with these doctrines belies their belief that these doctrines will prevent the abuses with which the Commission is concerned here.[50] The record contains ample evidence that the anti-trust laws do not apply to activities between the Pacific Telesis companies.[51] Therefore, in the absence of protection from anti-trust laws, the Commission must adopt additional safeguards recommended in Section V herein, to ensure that Pacific Telesis, Pacific Bell and PB Com do not engage in anti-competitive activities contrary to the public interest.

VI. The Commission Must Impose Dominant Regulation Upon PB Com to Mitigate the Lack of Structural Safeguards, and Ensure Compliance with the Costa Requirements.

As discussed herein, the evidence in this proceeding demonstrates sufficient reason to designate PB Com as a dominant carrier, not only because it's relationship with Pacific Bell provides it with many of the market advantages of its sibling affiliate, but because, without dominant regulation, Pacific Bell will be capable of evading it's own regulatory requirements when it migrates its customers to PB Com. Thus the integrity of Pacific's regulatory structure is dependent upon that structure being applied

[50] Tr. Vol. 10, Emmerson, PB Com at 1221.

[51] Id. at 1219, 1222; Ex. 105.

to PB Com. Moreover, these regulations are required in order to ensure compliance with the Telecommunications Act and Costa Bill requirements, as has been discussed herein. Specifically, CCTA recommends that the following regulatory constraints be attached to any CPCN authority granted to PB Com:

1. Dominant Carrier Regulation which includes:

   *Tariff filing requirements applicable to Pacific Bell
   *Price Floors and Imputation
   *Part 32 USOA Accounting

2. Accounting and Auditing Requirements

   *Annual outside audits to protect against cross-subsidy
   *Quarterly disclosure of financial information
   *Review of Cost Allocations

In addition, the Commission must declare void and illegal the existing contracts between PB Com and Pacific which violate the rules issued by the FCC in its First Report and Order. (See discussion Section IV infra.)

The Commission must also impose certain regulations upon Pacific Bell, in order to ensure that it is adhering to the non-discrimination requirements in the Telecommunications Act and Costa Bill.

1. Regulations to Protect Unfair Use of Subscriber Information

   *CPNI gathered and all releases obtained should be provided to all carriers on an equal time basis.

2. Equal Access Protections

   *Pacific must continue to adhere to equal access requirements before marketing PB Com's services.
   *Pacific must be precluded from marketing PB Com's services once a customer has expressed a choice of a long distance carrier.

3. Pacific must provide verifiable measures of its performance in order to ensure that it is in compliance with the non-discrimination requirements vis a vis the provision of facilities, etc.

4. The Commission should adopt expedited complaint procedures regarding compliance by Telesis (and/or SBC) and its affiliates, with the Telecommunications Act and Costa Bill requirements, to ensure that disputes are resolved in a timely fashion. Without this expedited procedure, Telesis and its affiliates may actually receive a substantial benefit by violating the Act or Costa Bill requirements, within the time of the resolution of a complaint.

VII. Conclusion

The evidence in this proceeding demonstrates that PB Com's proposals present clear dangers to ratepayer interests, consumer interests, and the interest in developing and sustaining a competitive telecommunications market. These proposals are contrary to the Costa requirements, as well as the nondiscrimination requirements of the Telecommunications Act of 1996. Thus, as presented in this case, PB Com's CPCN cannot be authorized.

In addition, affiliate transaction requirements and antitrust laws cannot be relied upon to remedy the concerns posed in this proceeding. As a result, the Commission must impose the conditions and requirements, including dominant carrier regulation, cited in Section V. herein, on the PB Com, as conditions to its CPCN, when the CPCN is authorized. Such authorization cannot be given prior to consideration of Pacific Bell's entry into the long distance market place, which is scheduled to take place in the

Managing Commissioner's Ruling Proceeding, and after approval for entry into the long distance market has been conferred by the FCC.

DATED: January 31, 1997

Respectfully submitted,

CALIFORNIA CABLE TELEVISION ASSOCIATION

Lesla Lehtonen, Assistant General Counsel
Darlene Clark, Attorney, Staff Regulatory
Alan Gardner
Vice President, Regulatory & Legal Affairs
CALIFORNIA CABLE TELEVISION ASSOCIATION
4341 Piedmont Avenue
Oakland, CA 94611

CERTIFICATE OF SERVICE

I hereby certify that I have this 31st day of January, 1997 served the foregoing document upon all known parties of record in this proceeding by sending a copy thereof to each such party by facsimile and/or by first-class mail.

Maria Politzer

Service List
A.96-03-007

William H. Booth
Jackson Tufts Cole & Black
650 California Street
San Francisco CA 94108-2613

David Discher
Pacific Bell Communications
140 New Montgomery Street #1510
San Francisco CA 94105

Dan Jacobsen
Pacific Bell Communications
5850 West Las Posadas Blvd #203
Pleasanton CA 94588

Terry J. Houlihan/Gregory Bowling
McCutchen, Doyle, Brown &
Enersen
Three Embarcadero Center
San Francisco CA 94111

John L. Clark
Goodin, MacBride, Squeri, Scholtz
505 Sansome Street - 9th Floor
San Francisco CA 94111

Peter A. Casciato
Law Offices of Peter A. Casciato
8 California Street #701
San Francisco CA 94111

William C. Harrelson
MCI Telecommunications Corp
201 Spear Street
San Francisco CA 94105

Stephen P. Bowen
Blumenfeld & Cohen
101 California Street #4225
San Francisco CA 94111

Reneé van Dieën
Sprint Communications Co LP
1850 Gateway Drive - 7th Floor
San Mateo CA 94404

Michael Morris
201 North Civic Drive #210
Walnut Creek CA 94596

Joseph S. Faber
Davis Wright Tremaine
One Embarcadero Center - 6th Floor
San Francisco CA 94111

Thomas J. Long
TURN
625 Polk Street #403
San Francisco CA 94102

Lee Burdick
Prima Legal Services
2317 Broadway #350
Redwood City CA 94063

Deborah Waldbaum/Karen Notsund
Teleport Communications Group
201 North Civic Drive #210
Walnut Creek CA 94596

Roger P. Downs
Cox California PCS Inc
2381 Morse Avenue
Irvine CA 92714

Carrington F. Phillip
Cox California Telecom Inc
1400 Lake Hearn Drive NE
Atlanta GA 30319

Bruce Holdridge
ICG Access Services Inc
180 Grand Avenue #1000
Oakland CA 94612

Dhruv Khanna
Intel Corporation
5200 NE Elam Young Parkway
Mail Stop HF3-03
Hillsboro OR 97124

Elaine Lustig/Kathleen Blunt
GTE California Inc
1 GTE Place - CA500LB
Thousand Oaks CA 91362

Martin Mattes
Graham & James
1 Maritime Plaza
San Francisco CA 94111

E. Garth Black/Mark Schreiber
Cooper, White & Cooper
201 California Street - 17th Floor
San Francisco CA 94111

Earl Nicholas Selby
Law Offices of Earl Nicholas Selby
420 Florence Street #200
Palo Alto CA 94301

Jerry Varcak
Bank of America
Box 37000 - Dept 13892
San Francisco CA 94137

Ken Snow
Gst Telecom
3478 Buskirk Avenue #1006
Pleasant Hill CA 94523

Mark E. Brown
Continental Communications
1 Sansome Street
San Francisco CA 94104

Rufus G. Thayer
DRA - CPUC
505 Van Ness Avenue
San Francisco CA 94102

Janice L. Grau
DRA - CPUC
505 Van Ness Avenue
San Francisco CA 94102

James S. Rood
DRA - CPUC
505 Van Ness Avenue
San Francisco CA 94102

Tom Lew
DRA - CPUC
505 Van Ness Avenue
San Francisco CA 94102

Brian Chang
DRA - CPUC
505 Van Ness Avenue
San Francisco CA 94102

Robert Benjamin
CACD - CPUC
505 Van Ness Avenue #3203
San Francisco CA 94102

Charles Christiansen
CACD - CPUC
505 Van Ness Avenue #3B
San Francisco CA 94102

ALJ Glen Walker
CPUC
505 Van Ness Avenue #5111
San Francisco CA 94102

Commissioner Josiah L. Neeper
CPUC - 5th Floor
505 Van Ness Avenue
San Francisco CA 94102